

STATE OF VERMONT
PUBLIC SERVICE BOARD

Docket No. 6107

Tariff filing of Green Mountain Power Corporation)
requesting a 12.9% rate increase, to take effect)
June 22, 1998)

PREFILED TESTIMONY OF
WILBUR L. ROSS, JR.
ON BEHALF OF THE
VERMONT DEPARTMENT OF PUBLIC SERVICE

September 18, 1998

Summary: The purpose of Mr. Ross's testimony is to discuss, in general terms, the financial position of Green Mountains Power ("GMP") and, more specifically, to discuss GMP's application for a rate increase of 12.93%.

Prefiled Testimony
of
Wilbur L. Ross

1 Q. Please state your name and address for the record.

2 A. My name is Wilbur L. Ross, Jr. I reside at 1111 Park Avenue, New York, New
3 York, 10128.

4 Q. What is your occupation?

5 A. I am a Senior Managing Director at Rothschild Inc., the United States affiliate of
6 the 200 year old worldwide Rothschild Group.

7 Q. Please briefly describe your educational background and professional experience.

8 A. This is set out in the curriculum vitae at Exhibit I to this testimony.

9 Q. Have you previously testified in regulatory proceedings?

10 A. Yes, I have testified in a number of proceedings, including proceedings regarding
11 Vermont Electric Corporation, Public Service of New Hampshire, El Paso Electric and
12 Long Island Lighting Co.

13 Q. What is the purpose of your testimony in this proceeding?

14 A. The purpose of my testimony in this proceeding is to discuss, in general terms, the
15 financial position of Green Mountains Power ("GMP") and, more specifically, to discuss
16 GMP's application for a rate increase of 12.93%.

1 Q. What is your general view of GMP's financial condition and what would you say are the
2 key factors that have contributed to this condition?

3 A. Having reviewed the information and testimony provided by GMP in this
4 proceeding, and publicly available information respecting GMP, I am of the view that
5 GMP is fundamentally a distribution company saddled with very expensive power supply
6 contracts and substantial unproductive non-utility investments. Its financial condition is
7 relatively weak because it has invested substantial sums in non-utility activities that have
8 yet to prove successful, has paid excessive amounts of dividends and has entered into a
9 high cost power supply contract with Hydro Quebec ("HQ").

10 Q. What evidence is there to question the wisdom of GMP'S non-utility investments?

11 A. Part 1 of Exhibit II details the growth in GMP's non-utility assets since 1994 and
12 compares this to the income contribution of these assets since 1994. It demonstrates that
13 although non-utility assets have grown approximately 26% since 1994, the income
14 contributed by non-utility assets (which includes non-regulated investments) has declined
15 roughly 58%. As Part 2 of Exhibit II demonstrates, revenues from non-regulated
16 businesses have continued to decline since 1994. This trend continues to the present day.
17 According to publicly available information, revenues at the non-regulated businesses
18 declined from \$6.036 million for the six months ended June 30, 1997 to \$2.109 million for
19 the six months ended June 30, 1998, a decline of more than 65%. Net losses for the six
20 months ended June 30, 1998 accelerated to \$1.294 million, from a loss of \$.937 million
21 for the six months ended June 30, 1997, an increase of more than 35%.

1 Q. What evidence is there to question GMP's decision to continue to pay dividends?

2 A. Exhibit III is a compilation of GMP's common stock dividends paid since 1994 in
3 relation to earnings. It shows that the company's common stock dividend payout has
4 ranged from 94% to 103% of earnings over the past 5 years. A normal payout for a utility
5 like this might be 60 to 70% of earnings. As the Exhibit indicates, in recent periods GMP
6 has literally had to borrow the money to make dividend payments. Since 1994 GMP has
7 paid out dividends of \$46 million; the cash flow difference since 1994, assuming the
8 dividend payout was reduced by 35%, is roughly \$16 million.

9 Q. How has the payment of dividends impacted GMP's capital structure?

10 A. It has effectively prevented GMP from taking concerted action to improve its debt
11 to capital ratios. Exhibit IV tracks the trend of GMP's indebtedness since 1994. As the
12 Exhibit indicates, GMP's net debt to total capital averaged 47% between 1994 and 1998.
13 Assuming that net dividend payments over this period were used to pay down debt, net
14 debt to total capital would have averaged 44%, a reduction of 300 basis points. If the net
15 dividend of \$29 million paid between 1994 and 1998 was available to pay down debt this
16 year the result would be pro forma net debt to total capital at June 30, 1998, ceteris
17 paribus, of approximately 32%. Instead, since 1994, GMP has paid a net dividend of \$29
18 million while increasing liabilities by \$11.135 million. The costs have been real: as a
19 result of GMP's failure to improve its capital structure, GMP has found itself in a situation
20 where its bank lenders have now asked it to grant security and reduce the time during
21 which it has access to bank funds to one year, while agreeing to an interest rate increase of
22 a full 30 basis points and a facility fee increase of 7 basis points (see Norse testimony).
23 While the payment of dividends may have helped shareholders in the short run, it has put
24 them in great peril in the long run.

1 Q. Apart from the payment of dividends and the investment in non-utility businesses, is there
2 any other instance in which GMP may not have used shareholder funds altogether
3 prudently?

4 A. The decision to prepay HQ \$8 million in October 1996 U.S. dollars as a result of
5 the most recently concluded negotiations with HQ is especially puzzling. Apparently the
6 money was paid because HQ threatened not to honor certain provisions of its contract
7 with GMP. But HQ had no contractual entitlement to this \$8 million prepayment. As
8 with some of the dividend payments by GMP, the payment of this money can only have
9 occasioned the need for increased borrowing by GMP. It is unclear why GMP would
10 agree to such a prepayment with reference to a contract producing power at 6 cents per
11 kWh, which is well above market. The only explanation offered by GMP is that it wished
12 to protect the accounting treatment of its renegotiated deal with HQ.

13 Q. Do you believe that GMP's proposal for a 12.93% increase in rates is justified?

14 A. Based upon Rothschild's analysis of information provided to us by the Vermont
15 Public Service Department ("VPSD"), we believe that a rate increase of 4.50%, as
16 opposed to the 12.93% increase requested by GMP, would preserve the utility's financial
17 integrity, provided that GMP engages in a simultaneous self-help program.

18 Q. What self-help measures do you think GMP should undertake?

19 A. The self-help should consist of three components. First, management must hold
20 to, or hopefully expand, the cost cutting measures, such as the staff reductions
21 commenced in March, which have reduced 1999 operating expenses. Second, GMP
22 should cancel its dividend – a company worried about its financial situation should not be
23 paying a dividend, even a reduced dividend. GMP's 1999 forecasts project the payment of
24 \$5.870 million in dividends on common stock, partially offset by \$1.727 million of
25 proceeds from stock issues, a net cash drain of \$4.143 million. Of course GMP could

1 resume paying the dividend after the company gets back on its feet, but in the short term,
2 stringent self help measures are required to restore the long term health of the company.
3 Finally, GMP should consider further trimming capital and operating expenses. Indeed,
4 according to information supplied to us by the VPSD, it appears that GMP could trim
5 planned 1999 expenses by up to \$13 million from those forecasted (see DPS 1-149).

6 Q. How will these measures enable GMP to maintain its financial integrity with a rate
7 increase of only 4.50.%, and not the 12.93% as requested?

8 A. Information supplied to us by the VPSD indicates that a rate increase of 4.50%,
9 when coupled with the other adjustments indicated therein, including the operating
10 expenditure reductions noted above, results in 1999 forecasted earnings available for
11 interest for the purposes of the first mortgage bond indenture of \$15,489,000 and an
12 overall cash flow deficit of \$11,681,109. Under the issuance test identified by Mr. Norse,
13 this results in an issuance capacity of about \$10,285,000 at 10% interest and \$11,427,777
14 at 9% interest. GMP can borrow under the credit facility to make up this deficit and
15 paydown the borrowing from first mortgage bond proceeds.

16 Q. What other measures do you think GMP could take to raise cash?

17 A. Possible additional measures include the disposal of GMP's interest in Mountain
18 Energy, Inc. and Rental Water Heaters. GMP has indicated that its investment in these
19 operations amounts to \$17.3 million and \$1.1 million, respectively, for a total of \$18.4
20 million. Also, GMP must renegotiate some of its current power supply contracts. There
21 is no good long term solution for GMP and the rate payer if the HQ and independent
22 power producer ("IPP") contracts are not brought closer to market levels.

1 Q. A prior witness has testified that conventional rate making would result in no rate
2 increase. Why should the State not follow conventional practice?

3 A. I believe that if GMP does not receive any rate increase it will have to file for
4 bankruptcy and that to do so abruptly would be undesirable.

5 Q. Wouldn't bankruptcy be a good way to reduce the excessive power costs?

6 A. It certainly would be one way to do so. I believe that, given time, a bankruptcy
7 could be organized so that vendors other than HQ and the IPP's would be paid on a
8 normal basis, as would the employees. The main thrust of the case would be moving to
9 abrogate the excessively priced power contracts without immediately triggering the step-
10 up provisions in the HQ contract. The mortgage bond holders and the banks would be
11 100% protected, but the amount of the unsecured claim created by the contract rejections
12 might wipe out the preferred and common equity. Hopefully HQ and the IPP's will
13 understand their risks in a bankruptcy proceeding and will negotiate an amicable
14 settlement out of court, without completely eliminating shareholder equity.

15 Q. Do you think that the recent ratings downgrades are fatal in terms of raising additional
16 debt in the public market?

17 A. No, I do not. In fact, Exhibit V identifies recent public capital raising activities by
18 utilities identified in the record by GMP (see IBM 2-168) as having similar or lower credit
19 ratings. As the exhibit indicates, some \$43 billion in bonds with similar or worse ratings
20 than GMP's corporate credit have been issued.

21 Q. Does that complete your testimony?

22 A. Yes it does.